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Certain of the independent establishments should be incorporated into existing or new departments. Others must remain wholly or in part outside the framework of departmental organization, but, where necessary, should be resolved into their several elements. Quasi-legislative functions should be assigned to agencies organized for the performance of such functions. Quasi-judicial functions should be assigned to agencies organized for the performance of such functions. The Interstate Commerce Commission, for example, and the Federal Trade Commission, perform certain duties which might not improperly be transferred to the Department of Justice. Others may be vested in any suitable partisan or administrative agency. The purely executive duties of the Interstate Commerce Commission alone would furnish ample employment for a large bureau in the Department of Commerce. Still other duties ought to be transferred to agencies whose non-

partisanship can never fail to be above suspicion.

These changes in administrative organization would probably save the Federal Government little, if any, money. On the other hand, they would certainly improve the efficiency of the services concerned. But most important of all, they would greatly strengthen the government in the confidence of the people. For the moment, public opinion seems disposed to make fewer demands upon the government for the increase of administrative activities than for a long time past. The opportunity should be seized to introduce sound methods of administration, to strengthen the administrative machinery, and to accumulate a stock of public confidence in the administrative capacity of the government which will stand it in good stead when opinion presently demands the assumption of new responsibilities towards the public, and heavier burdens again fall upon our administrative system.

## Earned and Unearned Income

By WILLFORD I. KING

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THE division of income into two broad categories denominated respectively as "earned" and "unearned" finds little or no sanction in standard texts on economics, but nevertheless, this classification is treated by many semi-scientific publicists as an accepted form of differentiation, and a considerable number of economists show a tendency either to use it in their writings or tacitly to admit its validity. Since, then, the usage of this terminology is becoming increasingly common, it seems worth while to inquire whether or not there exists a type of income which may justly be designated as

"unearned" and which, at the same time, possesses characteristics that make it desirable or necessary to place it in a separate category and perhaps to measure its importance or volume.

If there really is such a thing as "unearned" income, where may it be found? The Single Taxer will assure us that it consists wholly, or at least principally, of rent of land or of profits made through speculation in land. The Marxian will insist that it is made up of interest and the unreasonable gains of "profiteers." The view, however, which seems to find most general acceptance is that all income arising

through the ownership of property is perforce unearned.

Property may legitimately be defined as a legal title to anticipated income. Property and its income are, therefore, such closely related phenomena that it necessarily follows that if one is unearned the other must be also; for what is true of one is true of the other. What are the facts about both?

In order to answer this question, it is necessary first to determine upon a satisfactory meaning to be attached to the term "earned." As a first step in this direction, it is worth while to look into Webster's definition of the word. We find in his dictionary the word "earn" defined thus: "To gain as a just recompense for one's labor, service, etc." This concept doubtless accords with the idea which the word conveys to most of us and may be taken as a logical criterion in the classification of income.

According to this definition, it is clear that one does not earn unless he renders a service. It is questionable, however, if the rendition of a service always makes the recompense therefor truly earned. When one person serves another inadvertently or unintentionally, he can scarcely claim to have *earned* a reward. Probably most of us would agree that the act of earning requires that the service rendered shall require some effort or sacrifice on the part of the earner. With this idea in mind, we shall then set forth the following definition of the term as the one which will be adhered to in the succeeding pages: *Income is earned when it is obtained as a just recompense for deliberate effort or sacrifice made by the income receiver for the benefit of the payer of the reward.*

#### INCOME FROM PROPERTY

Having selected this definition of the term, let us next consider the ques-

tion of whether or not, in accordance with this principle, the income derived from property can ever legitimately be classed as earned. We may take first the case of a man who works diligently for another and receives as part of his pay a due bill or note. Such a certificate of indebtedness is a typical form of property; yet it is hard to see how the most rigorous Marxian could contend that such property has not been earned. Granted that the note has been earned, suppose that the note is exchanged for a house, is not the house also earned property? If so, does it not obviously follow that the services which the house yields to the owner are earned to exactly the same extent? Similarly, if the note is exchanged for a piece of land, is not the land likewise earned?

To once admit that any one kind of property may be earned, is thus evidently equivalent to admitting that all property may be earned; and to admit that property may be earned is to admit that the income from property may also be earned, for, as before stated, property is merely a title to such income.

At this point, however, the clever Marxian will interpose an objection. While admitting that the face value of the above-mentioned note may legitimately be referred to as earned, he will point out the fact that, when the note falls due, the owner is likely to demand, not only this earned principal, but also an additional sum known as interest, which, in the opinion of the Marxian, has in no sense been earned, but is merely extorted from the holder of the note. This analysis of the payment into two parts is entirely logical, and brings us face to face with the question of whether or not all interest necessarily falls into the category of unearned income.

## WEALTH AND ITS ACCUMULATION

Presumably no student of economics will deny that a necessary prerequisite to the advance of society from barbarism to civilization is the saving of tangible wealth and its accumulation into relatively large masses, each mass being under unified control. Thus, efficient farming requires an aggregation of live stock, machinery, buildings, fences and other equipment, the production of which has required years of work for some one. A modern factory represents such a concentration of wealth on a much larger scale, since it often embodies the results of millions of days of toil. Modern productive methods are therefore only possible because many persons have refrained from consuming some part of the output resulting from their respective efforts, and because, in one way or another, single managements have each been placed in control of large aggregates of such savings.

Saving and concentration of the control (though perhaps not necessarily the ownership) of wealth are, therefore, two foundation stones of civilization. How can these two fundamentals best be secured?

History affords examples of states in which powerful rulers or even private individuals through arbitrary power such as force of arms, the use of monopoly or the enslavement of sections of the population have accumulated property on a scale sufficient to permit of a reasonable rate of economic progress. But feudalism and despotism have been slowly but surely yielding before the march of democracy; hence, it is evident that, as devices for saving and concentration, they fail to satisfy modern public opinion. Uncontrolled private monopolies are almost universally detested, and have been declared in some of our state constitutions to

be contrary to the spirit of free peoples. Public sentiment in general apparently considers them as entirely undesirable institutions. What satisfactory methods of bringing about saving and concentrated control over property are then available?

Many socialists advocate the idea of making these processes functions of the state and of the state only. This solution of the problem is presumably a possible one, for the socialist state could retain each year such of the industrial output as the officials believed it necessary to devote to productive processes. As yet, however, our electorate have shown no disposition to place the industry of the country entirely in the hands of the government. As long as the voters remain of this mind, saving and concentration must be secured in some other way, if civilization is to continue.

Now the fact appears to be indisputable that the vast majority of human beings are so constituted that they prefer present to future goods; that is, for example, they would sooner have their cake today than a year hence; rather see a play tonight than next season. Under these circumstances, the natural tendency is to consume all wealth as fast as it is created.

Owing to this time preference for present goods, individual initiative, unless stimulated by some special incentive, fails to provide a sufficient supply of saving to meet the needs of modern industry. It has, therefore, been found just as necessary to pay those who save for their sacrifice in refraining from following their natural bent to use up all their income as soon as received, as it is to pay other persons for giving up their natural longing for rest or recreation, as they must do when they work in a shop, office or factory.

The average poor workingman would be just as ready to put in two hours of overtime as to wait four years to receive the five dollars which is coming to him as an ordinary day's pay. The dollar that he is paid as wages for overtime or the dollar that he receives as interest on the five dollars because he waits four years for his daily wage both represent payments for something which he will only do if pay therefor is in prospect. In many instances, therefore, payments for saving and payments for labor are both alike rewards paid to those who have suppressed their natural desires in order to serve the needs of others. If one is earned, so is the other also. The man who gathers wealth by refraining today from buying the things which he desires to consume at present, benefits society by accumulating property rights which he himself may use in bringing about more effective processes of production, or which he may loan to others who may use them for a like end. This service to society involves real sacrifice, and the interest which he receives in payment for this sacrifice is earned just as truly as are the wages for his labor.

However, it does not necessarily follow that all accumulation of wealth represents sacrifice. Some persons are so wealthy that it would be a great burden to be compelled to spend their entire income upon consumption goods. Saving by this class can not be said to involve abstinence. Their saving is inadvertent and the interest which they receive for the use of property rights thus accumulated can scarcely be classified as "a just recompense for services rendered."

Similarly, when a monopolist, by use of his peculiar power, gathers together property, he may be doing society a real service by such accumulation, but it is a stretch of the imagination to say that he has necessarily *earned* the

wealth amassed. His power has collected it, but the aggregation of resources has been secured only because others have been *compelled* to refrain from consumption. He himself may have given nothing—may have made no sacrifice. Likewise, not all amounts collected as wages are actually earned. Many an employe loafs on his job or does such poor work at times that he adds nothing to the output. Hence, we are forced to the conclusion that some parts of property income are earned and some parts unearned; that even wages and salaries, while perhaps usually earned, are also frequently unearned. The distinction between earned and unearned income can not, therefore, be validly based upon the premise that one comes from labor while the other is received in the form of interest payments or other returns from property. If earned income is to be distinguished from unearned income, the line of demarcation must be otherwise drawn.

#### INCOME FROM MATERIAL WEALTH

The followers of Henry George attempt to divide income from material wealth into two classes: that received as payments for the use of the gifts of nature, and that derived from artificial improvements on the land. The first type of income, they contend, is wholly unearned and therefore ought to be confiscated by the state.

Their doctrine rests entirely upon two assumptions: first, that all property in natural resources was originally acquired without making any adequate return to society therefor, and hence that most land titles rest originally on theft; second, that no valid transfer can be made of property acquired through theft. The first assumption, while based largely upon surmise, presumably corresponds fairly closely to the facts; the second premise, if carried to

its logical conclusion, leads to results not at all in conformity with the usual tenets of the Single Taxers. It requires but little acumen to perceive that if legal title can not be given to stolen goods, likewise legal title can be given to no part thereof or product derived therefrom. If all the land is stolen property, so obviously also are all the minerals dug from the land, all the wood cut from the land, all the crops grown on the land. Our monetary system rests on stolen gold; our houses are built of stolen wood and brick; our clothes are made of stolen cotton and wool; and our bread is composed of stolen wheat. This logic drives us perforce into the camp of the anarchists who condemn all private property because it rests on force.

The theory that to establish valid title we must hark back to the beginning of things is so palpably absurd as to seem unworthy of the consideration of any serious thinker. Yet, strangely enough, a recent writer of recognized ability has apparently endorsed this very doctrine in a disguised form.<sup>1</sup> The courts, however, are more logical in carrying back over only a relatively short period of time their investigations into the validity of titles. Modern business is only possible on the theory that unquestioned possession soon becomes practically equivalent to legal ownership.

We are then forced to the conclusion that, as long as men are permitted to exchange labor for money, and money for land, the property in the land and the rent of the land are neither more nor less earned than the property in the money itself. The effort to place in the category of unearned incomes all rents arising from gifts of nature evidently, therefore, results in absolute failure.

<sup>1</sup> Brown, Harry G. *The Theory of Earned and Unearned Incomes*, pp. 205-208.

#### UNEARNED INCREMENT

While the contention of Henry George, that all land rents are unearned, has been given relatively little support by orthodox economists, another doctrine originating in the ranks of the Single Taxers has received more serious consideration. This is the theory that increases in land value constitute an "unearned increment." The truth or falsity of this assumption may perhaps best be ascertained if we first consider the case of the coal merchant. He buys coal for twelve dollars and sells it for fourteen dollars a ton. Does he get an unearned increment? Most economists will agree at once that he does not. He is paid for his service in holding the coal in readiness for the customer—a process in which time utility is added to the coal. In exactly the same way, the land merchant who buys urban land in large tracts, and sells it off in small parcels on terms convenient to purchasers of limited means, earns a reasonable profit on the transaction.

The Single Taxer will at once reply that such instances are purposely chosen to avoid meeting his contentions fairly. He will say that the term "unearned increment" is applicable mainly to those cases in which the land has risen in value, not because of any effort of the owner, but solely as an effect of the growth in the demand for land, a factor over which the owner manifestly has no control. To illustrate, he will cite the instance of the man who purchases a city lot and does nothing to it whatever, but nevertheless eventually reaps a thousand per cent profit on his investment. Here, we are told, is a typical example of unearned increment.

The Single Taxer's contention in this case has much weight, though his opponents can argue with some reason

that, under existing social arrangements, any speculative gains made by an owner of earned property through its use are also earned. But if, for the sake of argument, we endorse the position of the Single Taxer in this respect, we can not stop without carrying the principle to its logical conclusion: namely, that all speculative or chance gains are unearned. There is no logical reason whatever for distinguishing between gains in the value of land and increases in the value of securities or commodities held for profit or speculation. If one is unearned increment, the other must be also.

It may be remarked in passing that only he who has never tried his hand at speculation will lean to the theory that unearned increments vastly exceed unearned decrements in point of size. The Single Taxer will assert that right at this point lies the distinction between unearned increments accruing from rising land values and those obtained from other lines. Increasing population, he will say, makes land rents, and therefore land values rise continuously, and hence the purchaser of land gains easily and certainly.

#### LAND VALUES

Such an assumption is apparently founded upon poor mathematical training. It can easily be shown by the use of elementary arithmetic or algebra that land value is the discounted sum of all *anticipated* future rents and this sum is likely to differ widely from the present rent divided by the current interest rate—a formula which is too commonly assumed to be universally applicable. If land values always varied in proportion to land rents, vacant city lots would evidently be practically valueless. Experience amply verifies the conclusion that the ratio of land values to rents is an extremely variable one. For example,

in a given locality, even though land rents are steadily rising, they are not going up as rapidly as people have expected; the town no longer promises to become soon the great metropolis which its promoters predicted as its not distant goal; and hence, the value of city lots is falling tremendously even while rents are still rising. In such an instance, not only does the expected unearned increment fail to materialize, but the speculator suffers a net loss.

Furthermore, even though land values have risen tremendously throughout the United States, it does not follow that most land speculators have made easy money any more than that we can assume that stock speculators on the "long" side are all profiting hugely during a "bull" market. Losses on the reactions are numerous, and immense paper profits are frequently never converted into anything more tangible.

There seems no reason, whatever, then, for differentiating speculative profits in land from speculative profits in any other field, or for supposing that land speculation has, in general, proved more lucrative than other forms of speculation; or even for assuming that the excesses of speculative gains over speculative losses in any line are more than sufficient to pay ordinary wages for the time devoted by the speculators to their dealings. It is, in fact, not at all impossible that speculative losses may, in amount, fully equal speculative gains.

In this connection, it may be well to call attention to the fact that superficial thinkers very commonly fail to distinguish between purely nominal gains and speculative profits. During the period 1914 to 1920, many owners of lands, stocks, etc., saw their property double in money value and they naturally felt that they had made great profits. But if they sold in 1920, they

quickly discovered that each dollar would buy only half as much as in 1914. They had no unearned increment, no speculative profit whatever, —nothing had happened but a change in the measuring stick of value—yet many of these unfortunate individuals had to pay heavy taxes on this imaginary increase in assets which would be pointed out by many as a splendid example of unearned income.

#### INHERITED INCOME

A type of income commonly referred to as wholly unearned is that received through inheritance. While it must be granted that much inherited income is unearned, it is just as certain that very considerable amounts of inherited property represent earnings of the heirs. When, for example, a man and wife, working together, accumulate property during a lifetime of hard work, the title commonly rests in the husband and, at his death, is often transferred to the wife. Although she is nominally an heir, yet it is absurd to say that this entire inheritance is, to her, unearned income. The same situation holds to no inconsiderable extent as regards property inherited by grown sons and daughters who, by their efforts, have contributed materially to its accumulation.

From the preceding discussion, it becomes evident that earned and unearned income can not be separated from each other by means of any rough and ready rule. Wages, salaries, interest, rent, profits from the purchase and sale of land or other commodities, property acquired through inheritance, all represent classes including some earned and some unearned incomes; and only by a searching analysis of each individual case can it be determined even approximately as to what proportion of the income in each class is justly entitled to be designated as unearned.

The distinction, then, while not especially difficult in theory, is extremely hard to apply to actual cases of income of individuals. Is there any real reason for attempting such a differentiation?

The only plea that seems to have been advanced for making such an attempt is in order that a higher tax rate may be levied on unearned than on earned incomes. Is a differentiation for this purpose wise?

At first thought, it seems only reasonable that unearned incomes should bear a heavier burden than earned. If they have been gained without effort, why not take them wholly or in part for the use of the state? Let us see, however, how such a policy will work in practice.

#### INHERITANCE TAX

In the case of inherited incomes, it is quite evident that earned incomes ought to be exempt from the inheritance tax, but is it feasible to measure the exact fraction earned? Furthermore, minor children who, in the nature of things, can have earned no part of their father's estate, have been in his mind when he saved for their benefit. Evidently, it would be unjust to subject their inheritance to heavy burdens simply because they have not earned it. Other bases for grading the inheritance tax rate, as for example, size of the estate, closeness of relationship, etc., seem to furnish equally logical criteria for this purpose, and they are much less difficult to apply.

#### SPECULATIVE PROFITS

Another important fraction of unearned income consists of speculative profits. Shall we tax those gains at a burdensome rate? If so, we shall discourage speculation unless we are prepared to pay out about the same amount of money to speculators who lose as we receive in taxes from those

who win. Is this desirable? Speculation tends to degenerate into gambling and gambling is generally recognized as an anti-social form of activity. The suppression of speculation would, then, perhaps lessen this evil. On the other hand, is not freedom to purchase and sell commodities at will essential so long as we prefer to maintain the competitive order? It is next to impossible to maintain even an approximation to freedom of trade without also having much speculation. Most economists agree that speculation tends to take the burden of risk from the shoulders of industry and to place it upon specialists who are willing to carry it; also, that speculation tends to stabilize prices. To crush out speculation by means of taxation, is, therefore, a policy of doubtful merit. Furthermore, it is extremely difficult to tell in any case where normal mercantile profits (or pay for the expense of carrying goods) end, and where speculative profits begin. On the whole, we could scarcely expect a differentiation of the tax rate on earned and unearned incomes to remedy any of the evils connected with speculation unless the tax is sufficient to practically abolish speculation, and the doing away with speculation seems almost certain to be impracticable as well as detrimental so long as we are not prepared to convert industry to a completely socialistic basis.

It appears, therefore; that a law requiring a differential tax rate upon earned and unearned incomes would give rise to such a host of difficulties in the classification of income that it would be wholly impracticable to make assessments with any reasonable approach to justice, and that even if assessments could be fairly made, the differentiation in the tax rate would be as likely to be harmful as beneficial.

As a matter of fact, however, pre-

sumably no one is seriously anxious to establish any such differential tax if a scientific basis of income classification is to be attempted.

#### TAX ON PROPERTY INCOMES

The whole movement for a higher tax rate on "unearned" incomes is merely a plan to put more burdens upon incomes from property and less upon receipts from salary or wages. This procedure is sometimes justified upon the theory that the income from property is more regular in its flow and hence can better stand taxation. Can it logically be said, however, that the regularity of receipt of income necessarily increases tax-paying ability? May it not, in fact, be true that the reverse is more commonly the case? Under a progressive system of taxation, unusual gains in an exceptional year are likely to mean heavy contributions to the public treasury, but most of this money has been easily obtained and can, therefore, be turned over to the government with relatively small sacrifice.

It is no doubt true that the larger the proportion of the tax burden laid upon funded incomes, the less it will be necessary to vary the tax rate from year to year in order to meet the normal expenditures of the government. This lightening of the duty of administrative officials scarcely seems, however, to be a matter of primary importance, and the advantages gained in this direction are much more than offset by the discouragement to saving, which would result if the income from present labor were taxed less and the fruits of past labor were burdened more heavily. Were the tax differential large enough to reduce saving radically, the necessary result would soon be either to lessen the average income of the people of the nation or else to bring about the substitution of governmental

for private saving. The proposal to tax property incomes at a higher rate than other incomes is, then, apparently intended merely as an entering wedge leading eventually at best to socialism; at the worst, to Bolshevism, or anarchy. Those favoring such a program should then do so because they favor one or the other of these ends, and not because they are attempting to install a less burdensome fiscal system or to secure a more equal distribution of wealth among the people. If the last mentioned program is deemed desirable, it can be much more logically and effectively accomplished by means of progressive income taxes and by a scientific system of inheritance taxation.

As a matter of fact, the attempt to divide incomes into categories designated as "earned" and "unearned" seems to serve no practical purpose and this classification appears to have been devised, not with any intent to aid science or statecraft, but in an effort to stigmatize the institution of private

property by subtly coupling with the name of the receipts derived therefrom an adjective having a derogatory implication.

Economists who carelessly use the term "unearned income" as a synonym for income arising from property are unwittingly playing into the hands of those who are thus attempting by insidious and devious methods to undermine the institution of private property. It goes without saying that scientists should avoid such a course, unless they deliberately desire to destroy this fundamental basis of the existing economic order, and, in that case, the correct policy would seem to bring the attack into the open and fight out the issue on its merits and demerits.

When economists unite in insisting upon a logical use of the term "unearned" as applied to income, it is more than probable that the term will soon be discarded as a superfluous addition to economic terminology.

## Better Methods of Municipal Bonding

By H. W. DODDS

Secretary, National Municipal League

**P**OLITICAL leaders have not given sufficient thought to the advantages which would flow from the adoption of an approved uniform municipal indebtedness law by the various states. While municipal bonds as a class will perhaps never be considered as secure an investment as United States bonds, there is, in many states, room for improvement. Improvident and unsound municipal financing in one part of the country reacts upon the market for all municipals. The recent difficulties experienced by several British Columbia cities, so serious as to cause the provincial minister of finance to

urge that the province assume their debts, will depress the market for all municipal bonds issued in northwestern Canada for some time to come.

If there is need for uniformity as between the various states, how much more pressing for any particular state is the matter of sound bonding practice for the cities within its borders. Large cities may develop a credit of their own, but with average cities credit is a mutual accomplishment. Only by uniformly sound practice can the municipalities (cities, counties and school districts), within a state create a market for their issues one hundred per